

ARTICLE FOR THE EDGE

WHERE IS TAIWAN HEADING?

Taiwan's independence-leaning President Tsai Ing-wen has won re-election with a resounding 57.1% of the votes, leaving her main opponent, Han Kuo-yu, of the China-leaning Kuomintang (KMT) with only 38.6%. Her Democratic Progressive Party (DPP) confounded pollsters by securing 61 seats, and so retaining control of the 113-seat legislature. That Tsai and the DPP achieved this as the turnout surged to 74.9% from 66% in the last elections in 2016, only added to the convincing nature of her victory.

The question is what this means for Asia and of course for Taiwan, which the Beijing leadership insists is part of China? There are two important ways in which this election will affect the rest of Asia. First, if China steps up all kinds of pressures on Taiwan, it could become a flashpoint between the US and China. Second, the election could put at risk the territory's tentative economic revival.

China's reaction could spell trouble for Taiwan and the rest of Asia

China is unlikely to become more accommodating of Taiwan following the election for a number of reasons:

At one level, China's President Xi Jinping has often repeated that he does not want the question of Taiwan's re-unification with China to be passed on from one generation of leaders to another. That suggests his occasional mention of re-unification by force if necessary should be taken seriously. Xi-watchers believe that Xi, who has just been proclaimed the "People's Leader", an honorific once only reserved for Mao Zedong, the founder of the People's Republic of China, hankers after being the leader who re-united all of China. That was something that even Mao could not achieve. Even if this view over-personalises the matter, it is clear that the political leadership in Beijing as well as most of the Chinese people would like to see Taiwan once again a full part of China.

In fact, this desire goes beyond just nationalism or emotion. A cursory look at the map shows why China cannot ever be militarily secure without controlling Taiwan. Taiwan is located just across from China's coastal regions where most of its political, economic and military assets are concentrated. Unlike the US, which is protected by two huge oceans and has land borders only with two friendly countries, China's coast is completely exposed to foreign invasion. Worse still, an increasingly hostile US has military bases in its neighbours, Japan and South Korea, and a strong US alliance with Taiwan. This defence vulnerability is simply untenable for China's leaders.

And, finally, China cannot be happy because the election makes clear that a separate sense of Taiwanese identity has taken root in a majority of Taiwanese. After all, Tsai had been trailing badly in the polls up to the middle of 2019 and the main reason why she was able to turn the tables on her opponent was that China's hardline stance on the Hong Kong protests aroused Taiwanese fears of what would happen to their democratic freedoms if China ever took control. The Hong Kong crisis has also persuaded most Taiwanese that the "One Country, Two Systems" model Hong Kong operates under and which Beijing has offered to Taiwan had failed. Indeed, surveys show an inexorable growth in Taiwanese identity – as of the middle of last year, around 57% of Taiwanese saw themselves as only Taiwanese while just 36% saw themselves as both Taiwanese and Chinese. Fewer than 4% saw themselves as purely Chinese. In 1992, less than 20%

of Taiwanese believed in a separate Taiwanese identity while about half saw themselves as both Chinese and Taiwanese. Despite the allure of growing rich in China's economic boom, young Taiwanese in particular reject a Chinese identity.

China will now realise that more and more Taiwanese are hostile to re-unification and even the KMT cannot be relied on any more to mobilise support for a closer relationship with China. Beijing has two choices – it could become more accommodating of Taiwanese aspirations for democracy and identity or it could more aggressively pursue its recent pressure tactics to bring Taiwan to heel. Unfortunately, there is nothing in China's recent conduct to suggest that it might choose the first option. Indeed, China reacted furiously to the election result, with Foreign Minister Wang Yi insisting that Taiwan's reunification with mainland China was inevitable and that separatists (i.e., Tsai and her supporters) would “stink for 10,000 years”. State media in the mainland has claimed that “external dark forces” had somehow manipulated the election result.

China's strategy appears to be to create such overwhelming pressure on Taiwan that over time, the Taiwanese people accept that the least bad option would be to accept reunification on Chinese terms. With this election result, the mainland authorities will want to intensify this approach. In the coming years we should expect China to:

- **Further limit Taiwan's diplomatic space:** China is likely to make it progressively more difficult for other countries to maintain economic and defence ties with Taiwan. China will no longer look the other way while countries enjoyed ties with both China and Taiwan: countries with relations with China will in future be expected to cut back on their relationship with Taiwan or face Chinese wrath if they demurred.
- **Undercut Taiwan's ability to reap economic gains from trading with and investing in China:** Because Taiwan's economy is so highly intertwined with China's, the Beijing authorities have much scope to undermine Taiwan's economy. It is unlikely, for example, that Beijing will renew the Economic Cooperation Framework Agreement when it expires in June. Beyond that, the mainland could, for example, impose regulations to inconvenience the roughly 10,000 Taiwanese companies that operate in the mainland or restrict their ability to repatriate profits back to Taiwan. China has already slashed the flow of mainland tourists to Taiwan. It could also press the roughly 1 million Taiwanese who work in the mainland to commit to Chinese nationality.
- **Step up infiltration and subterfuge within Taiwan:** China has been recruiting agents of influence and intelligence operatives in Taiwan, while trying to influence the grassroots there. Social media can be exploited more forcefully to create discord in Taiwanese society as well.
- **Increase military harassment of Taiwan:** Chinese military aircraft recently flew around Taiwan island in a show of force while its aircraft carrier sailed through the Taiwan Straits. These operations could be stepped up and more air and naval intrusions could unnerve the Taiwanese leaders while undermining confidence within Taiwan.
- **A quicker resolution of the Hong Kong crisis could enable the Beijing authorities to focus on Taiwan:** It makes sense now for President Xi to push ahead with efforts to bring the Hong Kong protests to a conclusion. The replacement of the

chief of China's liaison office in Hong Kong last week we believe is a precursor to such a resolution.

The trouble is that it is unlikely that the US or Japan would stand aside and watch Taiwan sink under Chinese pressure. The strategic and economic value of Taiwan to both these countries is immense and even an administration as transactional as the current American one is unlikely to be passive in the face of the likely Chinese campaign against Taiwan. The current mood in the US is increasingly hostile to China and Taiwan has deep support within the American national security groups, in Congress and among think tanks and academics who influence policy. In our minds, it is quite likely that Taiwan increasingly becomes a source of friction between China on one side and the US and Japan on the other.

Taiwan's economy is reviving - can it withstand Chinese pressure?

An ageing work force and a population that is expected to begin declining by 2021 are major headwinds to Taiwan's economic growth potential. These headwinds will worsen if anything but nevertheless Taiwan has enjoyed some good economic news of late.

Taiwan's economy appears to be regaining some of the verve it has been lacking in the past 20 years and which produced a long period of stagnant household incomes that spurred many Taiwanese to seek better jobs in the mainland and Taiwanese companies to invest there as well..

First and foremost is the relocation of production back to Taiwan from China: About USD24bn of investment is returning to Taiwan, much of it in high-technology. That will bring back demand for highly skilled jobs and a greater chance of reversing the stagnation in salaries of recent times. It will also help generate an eco-system of suppliers of components and services.

Second, while Taiwan still continues to grow its advantages in electronics and related areas, more new engines of growth are emerging:

- Taiwan's government is pursuing an aggressive shift away from nuclear power and has an ambitious commitment to reducing its carbon footprint. This has created a huge incentive to build up the renewables sector in Taiwan. Ten offshore wind projects are expected by the government to supply up to 738MW by 2020 and 3,098MW between 2021 and 2025. The government is also providing aggressive incentives for the development of solar power in the island. In fact, Taiwan's investment in research and development in this area has made it the second largest photovoltaic cell producer in the world while its highly innovative companies have developed very light panels for rooftop photovoltaic systems and photovoltaic curtain walls that are environmentally-friendly and highly efficient.
- Separately, government policies dating back to 1997 have helped create a sophisticated waste management sector in Taiwan replete with innovative new companies. Waste recycling has improved from below 6% 20 years ago to around 55% now.
- Taiwan has also made progress in its bio-technology sector which was worth about USD16bn in 2018. Its home-grown companies have made advances in developing breakthrough medications including precision medicine tailored for individual

patients, drug delivery systems and diagnostics while emerging as a leader in some areas of oncology.

- President Tsai's efforts to diversify its economy away from China also have had some success – Southeast Asian tourists have helped offset the decline in Chinese tourism. In 2019, despite stagnant Chinese tourist arrivals, the overall flow of foreign tourists reached a record 11.84 million, up 7% over 2018 and indeed the highest rate of increase since 2014.

The question then is – will China's political campaign against Taiwan undermine this putative revival? It is certainly a threat but it is worth noting that Taiwan has a vibrant and highly diverse corporate sector that could enable it to work around such threats. For a relatively small economy with around 23 million people, Taiwan has an impressive number of globally-scaled and indigenously-owned corporations some of whom are world leaders in high technology as well as in old industries such as shipping. In addition, it has a larger base of entrepreneurial, highly flexible home-grown small and medium enterprises. And it has practised judicious but highly successful form of state intervention (such as Hsinchu Science Park and the more recent bio-tech initiatives).

Conclusion

Taiwan is clearly at a turning point with important ramifications for the rest of Asia. A period of growing frictions between the US and China over Taiwan is possible as Chinese pressure on Taiwan grows. In the meantime, Taiwan's economy is regaining some of its vitality and could enjoy high quality of growth in coming years – so long as the political headwinds are contained.

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